May 2001

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sir/Madame,

No.BOT. FPG. /2544 Re : Comment on New Basel Capital Accord (Consultative Document Issued January 2001)

The Bank of Thailand, in cooperation with the Thai banking community, has conducted a thorough review of the New Basel Capital Accord (Consultative Document) issued by the Basel Committee on Banking Supervision in January 2001. As requested, we are offering our comments and opinions concerning the New Capital Accord, its modalities, and its implementation.

These comments are the outcome of a series of meetings held by a working group comprised of representatives from the Bank of Thailand and representatives from the Thai banking industry. In general, the working group appreciates the concept embodied in the principles set out in the New Basel Capital Accord. It also supports the main idea to build a framework that encourages financial institutions to develop risk management systems and procedures that allow management to better manage its risk and a capital adequacy measurement approach that is more risk sensitive and thus support improved economic efficiency.

When conducting our review of the New Capital Accord, the working group was particularly mindful of the fact the Thailand is just beginning to recover from an economic crisis. As a consequence, certain principles contained in the New Capital Accord – however appropriate they may be – may be difficult or impossible to implement at this time.

Shown below is a brief summary of the comments produced by the aforementioned working group. The full comments are contained in the enclosed attachment.

1. Scope of Application

- Application of the Accord to equity positions, whether significant or not, arising from debt–for–equity exchanges should be made clearer.
- The requirement to deduct certain equity investments from financial institution's capital seems excessive and should be reconsidered.
- In cases where the home and host supervisors apply a different capital options (for example, Option 1 or 2 with respect to claims on banks), the Accord should provide clear procedures and guideline for the parent financial institution, its subsidiaries, and branches located abroad to calculate capital.

2. Standardized Approach to Measuring Credit Risk

- The current proposal only recognizes financial collateral for credit risk mitigation purposes. Given that most collateral takes the form of real estate, it seems logical to allow nonfinancial collateral – with an appropriate haircut – to be used for credit risk mitigation purposes.
- The rationale for imposing a risk weight of 150% on a certain types of assets is not sufficient.
- The impact of having insufficient number of external credit rating agencies, particularly for developing countries, continues to be a major concern.

3. Internal-Rating Based Approach

- Applying the IRB approach based upon a target capital assumption that translates into an A credit rating may result in a higher capital charge for financial institutions in developing countries. It may even result in a higher capital requirement than what is produced using the Standardised approach. As a result, financial institutions will not have any incentive to migrate towards the more sophisticated measures for credit risk (i.e. the IRB approach) as envisaged by the New Accord.
- Legal, accounting, and other infrastructure weaknesses including availability of data and IT, may place developing countries at a comparative disadvantage when implementing the New Capital Accord. The Accord should consider these impediments when working towards the goal of creating a “level playing field”. In this regard, the Accord might contain an intermediate step between the Standardized Approach and the IRB Approach for those financial institutions in developing countries that are preparing themselves to move entirely towards the IRB approach.

4. Securitization

- The asset securitization scheme is too rigid to create an incentive for financial institutions to engage in the business of securitization. For instance, unrated claims have a risk weight of 100% while unrated asset-backed securities must be deducted from capital.

5. Operational Risk

- The definition of operational risk needs to be clarified as do many of the assumptions used in the operational risk capital charge calculation.

6. Interest Rate Risk

- The Accord should contain detailed procedures for bank management and supervisors to use when designing and assessing an interest rate risk management process.

7. Market Discipline

- Certain disclosures contained in the New Capital Accord require proprietary information to be revealed to the public. Doing so will undermine a bank’s competitive position.
- The Basel Committee should elaborate on the concept of “Reasonable Investor Test”, as it may vary from one country to another.

- The frequency of disclosures as required by the New Capital Accord may not be justified from a cost-benefit standpoint and should be reevaluated.

We appreciate the opportunity to comment on the New Capital Accord and look forward over the coming months to receiving updates on its development. If any of our comments are not clear or require elaboration please do not hesitate to contact Mrs.Tong-Urai Limpiti, Director, at TonguraL@bot.or.th, or Ms.Nawaporn Maharagkaga, Senior Executive, at NawaporM@bot.or.th, at the Financial Institutions Policy Group of the Bank of Thailand.

Best regards,

Enc.: Comment on New Basel Capital Accord (Consultative Document Issued January 2001)

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